Governor's Statement - Second Bi-Monthly Monetary Policy, 2019-20, June 6, 2019

During June 3rd and 4th, 2019 the Monetary Policy Committee (MPC) assessed recent macroeconomic developments and the outlook. In its meeting today, it voted unanimously to reduce the policy repo rate by 25 basis points, and to change the stance of monetary policy from neutral to accommodative. The unanimous vote reflects the resolve of the MPC to act decisively and act in time.

2. I thank the MPC members for the rich and fruitful discussions, which are reflected in the resolution and the policy decision.

3. I also wish to express my gratitude to our teams in the Reserve Bank for their hard work and diligence in providing valuable support to the MPC in its work.

4. Let me now turn to the key global and domestic developments that the MPC reviewed. At the outset, it noted that global economic activity has not been able to sustain the improved performance seen in the first quarter of calendar 2019 in the face of the deepening slowdown in trade and manufacturing, which has impacted advanced and emerging market economies alike. Inflation remains below target in several economies. In advanced economies, incoming data for the second quarter of 2019 point to loss of momentum relative to the first quarter. In major emerging market economies, economic activity has either slowed or has contracted. It is in this context that central banks across the world have moved to an accommodative stance in setting monetary policy. Financial markets have been unsettled by the acrimonious US-China trade tensions. Crude oil prices remained volatile,

reflecting evolving demand-supply conditions and geo-political concerns. Most EME currencies have depreciated against the US dollar.

5. On the domestic front, the MPC noted that the May 31st, 2019 data release of the National Statistical Office (NSO) showed that GDP growth for 2018-19 has been placed lower by 20 basis points at 6.8 per cent, relative to its February 28th estimate. In Q4 of 2018-19, GDP growth decelerated sharply to 5.8 per cent, down from 6.6 per cent in Q3 and 8.1 per cent a year ago.

6. On the supply side, agriculture and allied activities contracted, while manufacturing activity weakened sharply. Service sector growth accelerated, although construction activity slowed down markedly. Looking ahead, the India Meteorological Department (IMD) has predicted that south-west monsoon rainfall (June to September, 2019) is likely to be normal at 96 per cent of the long period average (LPA). The third advance estimates of food grains production at 283.4 million tonnes for 2018-19 were lower by only 0.6 per cent as compared with the final estimates for the previous year. Further, the stock of food grains at 72.6 million tonnes as on May 16th, 2019 were 3.4 times the prescribed buffer norms, and provide a backstop against any supply disruptions due to weather adversities. In the industrial sector, growth in eight core industries decelerated sharply in April. Credit flows from banks to large industries strengthened, though they remained muted for micro, small and medium industries. Seasonally adjusted capacity utilisation (CU) in the manufacturing sector slipped to 75.2 per cent in Q4 from 75.8 per cent in Q3. Imports of capital goods – a key indicator of investment activity – remained anaemic in April. High frequency indicators suggest moderation in activity in the service sector.

7. Turning to inflation, the MPC took note of the fact that retail CPI inflation remained unchanged in April from its March level of 2.9 per cent. Higher inflation in food and fuel groups was offset by lower inflation in items excluding

food and fuel. Inflation expectations of households in the May 2019 round of Reserve Bank's survey declined by 20 basis points for the three-month ahead horizon compared with the previous round but remained unchanged for the one-year ahead horizon. Nominal growth in rural wages and in organised sector staff costs remained muted.

8. Liquidity in the system turned into an average daily surplus in early June after remaining in deficit during April and most of May due to restrained government spending. Apart from liquidity injections through LAF operations, the Reserve Bank conducted two OMO purchase auctions in May amounting to ₹25,000 crore and a US dollar buy/sell swap auction of US$ 5 billion (₹34,874 crore) for a tenor of 3 years in April to inject durable liquidity into the system. An OMO purchase auction of ₹15,000 crore (₹150 billion) on June 13, 2019 has also been announced.

9. Transmission of the cumulative reduction of 50 bps in the policy repo rate in February and April 2019 was 21 bps to the weighted average lending rate (WALR) on fresh rupee loans. Interest rates on longer tenor money market instruments remained broadly aligned with the overnight WACR, reflecting near full transmission of the reduction in policy rate. The 10-year government securities benchmark yield has also declined by about 40 basis points from its average in April 2019 to about 7 per cent. This was the position before the announcement of the MPC resolution today. The Reserve Bank will ensure that adequate liquidity is available in the system for all productive purposes.

10. Exports grew by 0.6 per cent in April 2019, but imports grew at a somewhat accelerated pace, leading to a widening of the trade deficit. After a sharp recovery in March 2019, net foreign portfolio inflows have been relatively modest at US$ 2.3 billion in 2019-20 in April-May. India's foreign exchange reserves were at US$ 421.9 billion on May 31, 2019.

11. Taking into account these factors, the impact of recent policy rate cuts and assuming a normal monsoon in 2019, the MPC revised the path of CPI inflation to 3.0-3.1 per cent for H1:2019-20 and 3.4-3.7 per cent for H2:2019-20, with risks broadly balanced, as against 2.4 per cent for Q4:2018-19, 2.9-3.0 per cent for H1:2019-20 and 3.5-3.8 per cent for H2:2019-20. Risks around the baseline inflation trajectory emanate from uncertainties relating to the monsoon, unseasonal spikes in vegetable prices, international fuel prices and their pass-through to domestic prices, geo-political tensions, financial market volatility, and the fiscal scenario.

12. The headline inflation trajectory remains below the target even after taking into account the expected transmission of the past two policy rate cuts. Hence, there is scope to boost aggregate demand, and in particular, private investment activity, while remaining consistent with the mandate of flexible inflation targeting. The MPC also revised the projection of GDP growth for 2019-20 to 7.0 per cent – in the range of 6.4-6.7 per cent for H1:2019-20 and 7.2-7.5 per cent for H2 – with risks evenly balanced, as against 7.2 per cent – in the range of 6.8-7.1 per cent for H1 and 7.3-7.4 per cent for H2 – with risks evenly balanced. The MPC noted that growth impulses have significantly weakened as reflected in a further widening of the output gap

13. Let me now set out some developmental and regulatory policy measures that we have announced today.

14. In the area of regulation and supervision, banks have been monitored against an indicative Basel III Leverage Ratio of 4.5% to mitigate risks of excessive leverage. Keeping in mind financial stability and with a view to moving further towards harmonization with Basel-III standards, it has been decided that the minimum Leverage Ratio should be 4% for Domestic Systemically Important Banks (DSIBs) and 3.5% for other banks.

15. In pursuance of the Guidelines for Licensing of Payments Banks and Small Finance Banks of November 27, 2014 it is proposed to issue Draft Guidelines for 'on tap' Licensing of Small Finance Banks by the end of August 2019. More time is, however, needed to review the performance of Payments Banks before considering the licensing of more payment banks to be 'on tap'.

16. It may be recalled that in August 2010, the Reserve Bank introduced a separate framework for the regulation of systemically important Core Investment Companies (CICs). In the light of the increased complexity of these corporate structures, their growing inter-connectedness with the financial system and the various recent developments, it has been decided to set up a Working Group to review the regulatory guidelines and supervisory framework applicable to CICs.

17. Turning to financial markets, it has been decided to constitute an Internal Working Group to review comprehensively the existing liquidity management framework and suggest measures to simplify the current liquidity management framework and clearly communicate the objectives, quantitative measures and toolkit of liquidity management by the Reserve Bank. The Group is expected to submit its report by mid-July 2019.

18. In October 2017, the Reserve Bank had proposed the setting up of a foreign exchange trading platform for retail participants that would provide customers with access to an electronic trading platform through an internet-based application on which they can purchase/sell foreign currency at market clearing prices. The trading platform has now been developed by the Clearing Corporation of India (CCIL) and is being tested by users. The platform will be available to users for transactions from early August 2019. Operational guidelines for the platform shall be issued by the end of June 2019.

19. It has been the endeavour of the Reserve Bank to increase retail participation in the government security market. In addition to scheduled commercial banks and primary dealers, it has been decided to also allow the Specified Stock Exchanges approved by SEBI to act as Aggregators/Facilitators to aggregate the bids of their stockbrokers/other retail participants and submit a single consolidated bid under the non-competitive segment of the primary auctions of State Development Loans (SDLs). The measure will be implemented in consultation with the respective State governments.

20. In the area of payment and settlement systems, it has been decided to do away with the charges levied by the Reserve Bank for transactions processed in the RTGS and NEFT systems in order to provide an impetus to digital funds movement. Banks will be required, in turn, to pass these benefits to their customers. Instructions to banks in this regard will be issued within a week.

21. Finally, with the usage of Automated Teller Machines (ATMs) growing significantly, it has been decided to set up a Committee involving all stakeholders, under the chairmanship of the Chief Executive Officer, Indian Banks' Association (IBA), to examine the entire gamut of ATM charges and fees. The Committee is expected to submit its recommendations within two months of its first meeting.

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